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RUEHPE/AMEMBASSY LIMA PRIORITY 1790
RUEHBR/AMEMBASSY BRASILIA PRIORITY 3767
RUEHGL/AMCONSUL GUAYAQUIL PRIORITY 2576
RUEHSO/AMCONSUL SAO PAULO PRIORITY 0194
RUEHRI/AMCONSUL RIO DE JANEIRO PRIORITY 0046
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RUEATRS/DEPT OF TREASURY WASHDC PRIORITY

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TREASURY FOR MMALLOY AND MEWENS

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TAGS: [ECON](#) [EPET](#) [EINV](#) [PREL](#) [EC](#)
SUBJECT: PETROBRAS INVESTIGATION COULD LEAD TO CONTRACT
CANCELLATION

REFTEL: 06 Quito 1216

¶1. (SBU) Summary: Brazilian state petroleum company Petrobras is being investigated for possible contract violations that could lead to the cancellation of its contract. The allegations echo those leveled at U.S. firm Occidental Petroleum, whose contract was subsequently cancelled and assets seized in 2006. Ecuador's Prosecutor General initially came out strongly against Petrobras but then softened his tone, while the Minister of Petroleum and Mining has said further technical investigation is necessary. Petrobras has not been formally notified of potential irregularities and denies any wrongdoing. End Summary.

GOE INVESTIGATES IRREGULARITIES

¶2. (SBU) Before Energy Minister Alberto Acosta left office in June, he reportedly wrote a number of letters requesting investigations into foreign oil company petroleum contracts, including one to the President mentioning possible contract violations by Brazilian state oil company Petrobras. Petrobras produces close to 35 thousand barrels of petroleum per day and has operated in Ecuador since 1996.

On July 3, a government report was submitted to acting Energy Minister Jorge Alban (later acting Petroleum and Mining Minister when the Ministry split July 10), alleging Petrobras's contract may be cancelled ("caducity") for violations. The report allegedly suggests suspension of Petrobras's contract and seizure of its assets for the irregularities.

¶3. (SBU) Press coverage of GOE statements indicate the report (which is not publicly available; even Petrobras has not been able to obtain a copy) alleges two distinct violations. The first is that Petrobras sold a 40% stake in its operations to Japanese firm Teikoku without Ministry of Energy consent in 2005. This is the more serious accusation, and some have said the action warrants caducity because it is the same violation U.S. firm Occidental Petroleum allegedly committed (Occidental's contract was cancelled in 2006 for unapproved transfers and its substantial assets seized, ref tel). The second is related to the operation of Petrobras's Palo Azul 1 and 2 fields. In 2000, the Energy Ministry declared that the two fields were linked, permitting Petrobras to operate Palo Azul 2 which had belonged to state firm Petroecuador. However, the report alleges the fields are not connected and therefore Petrobras's operation of Palo Azul 2 is illegal because it still belongs to

Petroecuador.

OFFICIALS ARGUE BACK AND FORTH

14. (SBU) Petrobras issued a statement denying irregularities in its operations in Ecuador. Several days later, Ecuador's Prosecutor General announced that the issue was being investigated by his office, and that the GOE would probably have to consider cancelling Petrobras's contract (suggesting such cancellation was imminent). On July 10, acting Minister of Petroleum and Mining Jorge Alban countered by announcing that the issue was under analysis by the Anticorruption Secretariat, and that following the analysis, Petroecuador would investigate and produce a technical, legal, and economic report. The Prosecutor General then backpedaled slightly and issued another statement noting that there was a large difference between the Petrobras situation and the Occidental situation - that Occidental had never notified the Ministry about the sale of its assets, but Petrobras had (although he noted that other irregularities would be looked into). He also emphasized that "the final word is with the Petroleum Ministry." On July 18, Alban reported that a new technical and legal commission had been created to investigate the irregularities and ensure an unbiased analysis.

PETROBRAS DENIES WRONGDOING

15. (SBU) To date, Petrobras has not received public notification of an investigation. The company's press release on the issue states that it has done nothing wrong and would be happy to provide all documentation if requested by the GOE. Petrobras representative Fernando Enmanuel notes that the firm cannot even get a copy of the report alleging misconduct. He claims the transfer to Teikoku was approved by former Energy Minister Ivan Rodriguez, and that the

issue of the Palo Azul fields being linked was approved by government technicians in 2001. He hopes that the tapering off of strong government messages on caducity means the issue might fade away.

COMMENT:

16. (SBU) The back and forth nature of the statements by the Prosecutor General and the Petroleum Minister offer a glimpse of the contradictory government assertions often seen in the press, and the lack of clear guidance in the sector. This is likely compounded by frequent changes in the Ministry. Spanish firm Repsol is also being investigated for a possible contractual irregularity, although the potential violation is much less significant than Petrobras's. Petrobras representative Enmanuel commented that some insiders consider the investigations a way for Petroecuador to gain leverage and a better negotiating position before initiating contract renegotiations with foreign oil companies. Head of Ecuador's hydrocarbons association Rene Ortiz blames the lack of investment in the petroleum sector on lack of judicial security, as evidenced by the uncertainty surrounding these allegations. While the allegations linked to Occidental became much more politicized and public, these events show that the U.S. and its companies are not alone in dealing with the difficulty of operating in the energy sector in Ecuador.

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